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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

December 16, 2003

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street S.W.
Washington, DC 20554

RE: *EX PARTE* WRITTEN PRESENTATION
DOCKETS MB 02-144, MM 92-266, MM 93-215, CS 94-28, CS 96-157

Dear Madame Secretary:

Pursuant to 47 C.F.R. § 1.1206(b)(1) and *In re* Revisions to Cable Television Rate Regulation, Docket No. MB 02-144, FCC 02-177, 17 FCC Rcd. 11550, 11577-78 ¶ 83 (2002), enclosed are ten copies of a written *ex parte* presentation related to the aforementioned dockets.

Very truly yours,

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MILLER & VAN EATON, P.L.L.C.

Frederick E Ellrod III

By

Frederick E. Ellrod III

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Wanda Hardy
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445 12th Street S.W.
Washington, DC 20554

RE: *EX PARTE* WRITTEN PRESENTATION
DOCKETS MB 02-144, MM 92-266, MM 93-215, CS 94-28, CS 96-157

Dear Mr. Norton and Ms. Hardy:

Enclosed is supplemental filing submitted on behalf of the National Association of Telecommunications Officers and Advisors, the National League of Cities, the Miami Valley Cable Council, Montgomery County, Maryland, and the City of St. Louis, Missouri, in the Commission's proceeding *In re* Revisions to Cable Television Rate Regulation, Docket No. MB 02-144. Two copies have been submitted to the Office of the Secretary as an *ex parte* written presentation pursuant to 47 C.F.R. § 1.1206(b)(1) and *In re* Revisions to Cable Television Rate Regulation, Docket No. MB 02-144, FCC 02-177, 17 FCC Rcd. 11550, 11577-78 ¶ 83 (2002).

Very truly yours,

MILLER & VAN EATON, P.L.L.C.

By

Frederick E. Ellrod III

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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C 20554

In the Matter of: Revisions to Cable Television Rate Regulations	MB Docket No 02-144
Implementation of Sections of The Cable Television Consumer Protection and Competition Act of 1992. Rate Regulation	MM Docket No. 92-266
Implementation of Sections of The Cable Television Consumer Protection and Competition Act of 1992. Rate Regulation	MM Docket No. 93-215
Adoption of a Uniform Accounting System for the Provision of Regulated Cable Service	CS Docket No. 94-28
Cable Pricing Flexibility	CS Docket No. 96-157

SUPPLEMENTAL FILING OF THE NATIONAL ASSOCIATION OF TELECOMMUNICATIONS OFFICERS AND ADVISORS; THE NATIONAL LEAGUE OF CITIES; THE MIAMI VALLEY CABLE COUNCIL; MONTGOMERY COUNTY, MARYLAND; AND THE CITY OF ST. LOUIS, MISSOURI

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December 16, 2003

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C 20554

In the Matter of: Revisions to Cable Television Rate Regulations	MB Docket No. 02-144
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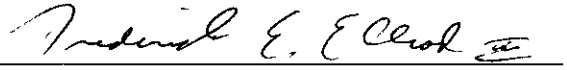
SUPPLEMENTAL FILING OF THE NATIONAL ASSOCIATION OF TELECOMMUNICATIONS OFFICERS AND ADVISORS; THE NATIONAL LEAGUE OF CITIES; THE MIAMI VALLEY CABLE COUNCIL; MONTGOMERY COUNTY, MARYLAND; AND THE CITY OF ST. LOUIS, MISSOURI

In October 2003, the U.S. General Accounting Office ("GAO") released a report entitled *Telecommunications. Issues Related to Competition and Subscriber Rates in the Cable Television Industry*, Report to the Chairman, Committee on Commerce, Science, and Transportation, U S. Senate, GAO-04-8 (Oct. 24, 2003). This report represented a follow-up to an earlier GAO study, *Telecommunications Issues in Providing Cable and Satellite Television Services*, Report to the Subcommittee on Antitrust, Competition, and Business and Consumer Rights, Committee on the Judiciary, U.S. Senate, GAO-03-130 (Oct. 15, 2002). Both reports are of considerable importance to the issues addressed in this rulemaking. Accordingly, we hereby

submit those two reports, copies of which are attached, for inclusion in the record of the above-captioned proceeding.

Respectfully submitted,



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December 16, 2003

United States General Accounting Office

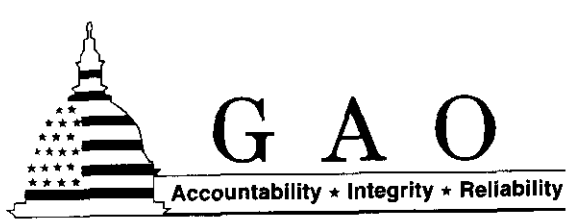
GAO

Report to the Subcommittee on Antitrust, Competition, and Business and Consumer Rights, Committee on the Judiciary, U.S. Senate

October 2002

TELECOMMUNICATIONS

Issues in Providing Cable and Satellite Television Services



GAO-03-130

United States General Accounting Office October 2002

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Highlights

TELECOMMUNICATIONS
Issues in Providing Cable and Satellite Television Services

Highlights of GAO-03-130, a report to the Subcommittee on Antitrust, Competition, and Business and Consumer Rights, Committee on the Judiciary, U S Senate

Why GAO Did This Study

Direct broadcast satellite (DBS) television service has grown to become the principal competitor to cable television systems. In October 2001, the two primary DBS companies, EchoStar and DirecTV, proposed a merger plan that is pending before the Department of Justice and that the Federal Communications Commission (FCC) recently announced that it had declined to approve. GAO was asked to examine several issues related to competition in providing subscription video services, including the competitive impact of the availability of cable modem Internet access, and the effects on cable prices and DBS penetration rates of DBS' offering local broadcast channels. GAO also examined the technical capability of the individual DBS companies to expand local channel services into more television markets. This report offers no opinion on the merits of the proposed merger.

What GAO Found

DBS and cable companies compete for subscribers to their video services and to their Internet access services, although to date, cable modem service is the most popular method of broadband home Internet access. On the basis of a random survey of 3,000 individuals, it appears that the availability of Internet access services is important for some consumers—although not the majority of consumers—when they are considering various video service providers.

In 1999, DBS companies began to offer local broadcast channels in select television markets across the country. According to results from GAO's econometric model, the provision of local broadcast channels by DBS companies is associated with significantly higher DBS penetration rates, although GAO found no evidence that DBS provision of local channels influences cable prices. In general, GAO's model results suggest that DBS is able to compete more effectively for subscribers with cable in areas where DBS subscribers can receive local broadcast channels.

The two DBS companies have stated that if they merge, they will, as a combined entity, have sufficient satellite capacity to provide local broadcast programming in all 210 television markets and to introduce new services. GAO's technical expert's review of various documents related to the two DBS companies' satellite capacity indicates that—given current technologies and deployed assets—neither company would individually be able to offer all of the local channels in all markets. However, the decision of whether to introduce more local channels is, in the long term, a business decision. Whether the benefits would outweigh the costs for the individual companies to eventually offer local channels in all 210 television markets is not clear.

Both FCC and the Department of Justice declined to provide comments on the substance of this report because of the merger proceedings.

The full report, including GAO's objectives, scope, methodology, and analysis is available at www gao gov/cgi-bin/getrpt?GAO-03-130 For additional information about the report, contact Peter Guerrero (202-512-2834)

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Abbreviations

2SLS	Two-Stage Least Squares
3SLS	Three-Stage Least Squares
BLS	Bureau of Labor Statistics
CUID	Community Unit Identification
DBS	direct broadcast satellite
DMA	designated market area
DSL	digital subscriber line
DTV	digital television
FCC	Federal Communications Commission
HD	high definition
MABLE	Master Area Block Level Equivalency
MSA	metropolitan statistical area
MSO	multiple system operator
ORC	Opinion Research Corporation

GAO
Accountability * Integrity * Reliability
United States General Accounting Office
Washington, D.C. 20548

October 15, 2002

The Honorable Herb Kohl
Chairman
The Honorable Mike DeWine
Ranking Minority Member
Subcommittee on Antitrust, Competition, and
Business and Consumer Rights
Committee on the Judiciary
United States Senate

Since its introduction in 1994, direct broadcast satellite (DBS) service has grown dramatically as a means of delivering television programs to U.S. households and is now the principal competitor to cable companies for subscription video services. Subscribers to DBS services use small reception dishes to receive signals beamed down from satellites in orbit over the equator. As of June 2002, more than 18 million households were served by DBS. The ability of DBS companies to compete against cable was bolstered when DBS companies gained the legal right to provide local broadcast channels—that is, to offer the signals of local over-the-air broadcast stations (such as affiliates of ABC or NBC)—via satellite to their customers.[1] In addition to video services, DBS and cable also compete for subscribers to their broadband (i.e , high speed) Internet access services, which is sometimes sold as a package with video services. There are currently two primary DBS providers in the United States: Hughes Electronics' DirecTV and EchoStar's DISH Network. In October 2001, DirecTV and EchoStar proposed a merger plan that is now pending before the U.S. Department of Justice (Justice). On October 10, 2002, the Federal Communications Commission (FCC) announced that it declined to approve the merger because FCC found that the transaction would not serve the public interest, convenience, and necessity. FCC provided for a full evidentiary hearing before an Administrative Law Judge.

As agreed with the Subcommittee, this report provides information on (1) whether the availability of cable modem Internet access service appears to be affecting the competitiveness of DBS companies in the provision of video services, (2) whether cable prices and DBS penetration rates appear

[1]This is often referred to as the provision of "local-into-local" because the signals of broadcasters within a specific television market must be transmitted up to the satellite for transmission back down into that same television market

to be affected in areas where the DBS companies offer local broadcast channels, and (3) whether the two individual DBS companies are technologically capable of expanding local broadcast channel services into all 210 television markets in the United States.

To address these questions, we developed a telephone survey, projectable to the U.S. population, to explore consumers' reasons for selecting video services We also updated a prior GAO econometric model to examine whether the availability of local channels from a DBS company, as well as other factors, influenced the level of cable prices and DBS penetration rates (measured as the ratio of DBS subscribers to housing units).[2] Finally, a GAO senior technologist analyzed technical information provided by DirecTV and EchoStar and other interested parties on the capacity of the DBS systems. A more detailed discussion of our scope and methodology is provided in appendix I. The consumer survey questions and responses are contained in appendix II. A complete discussion of the econometric model development, including data sources, a table of descriptive statistics for all variables, estimation design, model results, and alternative specifications, is contained in appendix III. We conducted our review from February 2002 through September 2002 in accordance with generally accepted government auditing standards.

Our objectives did not include an assessment of the proposed merger of DirecTV and EchoStar and, therefore, this report offers no opinion on the merits of the proposed merger.

Results in Brief

Responses to our consumer survey suggest that the availability of Internet access services is important for some consumers—although not the majority of consumers—when they are considering various video service providers. In particular, just over half of the respondents to our survey said that when thinking about purchasing television programming service, the availability of cable modem Internet service would not make them more likely to consider cable video service over DBS video service. However, almost one-third of respondents said that when thinking about purchasing television programming service, the availability of cable modem Internet service would make them "moderately more likely" or "much more likely" to consider cable over DBS, and these respondents were more likely to

[2]See U S General Accounting Office, *Telecommunications The Effect of Competition From Satellite Providers on Cable Rates*, GAO/RCED-00-164 (Washington, D C July 18, 2000)

have a higher household income and to be younger than respondents not influenced by the availability of cable modem service. Most respondents (88 percent) said they had never considered satellite Internet service.

According to results from our econometric model, the provision of local broadcast channels by DBS companies is associated with significantly higher DBS penetration rates, although we found no evidence that DBS provision of local channels influences cable prices. Specifically, our model results indicate that in areas where DBS subscribers can receive local broadcast channels from both DBS companies, the DBS penetration rate is approximately 32 percent higher than in areas where subscribers cannot receive local broadcast channels via satellite. Thus, it appears that DBS is able to compete more effectively for subscribers with cable in areas where the DBS companies offer local channels than in areas where the DBS companies do not offer local channels, although this competitiveness had not led to lower cable prices by 2001.

On the basis of our expert's review of current DBS technologies and deployed assets, it appears that neither company, at this time, would be able individually to offer all of the local broadcast channels in all 210 television markets while simultaneously maintaining a competitive national subscription television service. Over time, however, each company could make a business decision to introduce local channels in more markets than they currently plan to serve by deploying additional assets and new technologies Whether the business case—the costs of deploying additional assets versus the benefits of gaining additional subscribers—would justify the individual companies' introduction of local channels in all 210 television markets is not clear. Additionally, the ongoing transition of all broadcast television stations from analog to digital television technologies allows broadcasters to provide high definition television signals, which require more satellite capacity to transmit than traditional analog signals. At this time, the DBS companies' business decisions about local digital broadcast carriage at the completion of the DTV transition is also unclear.

We provided a draft of this report to FCC and Justice for their review and comment. FCC staff provided minor technical comments that were incorporated as appropriate. Both FCC and Justice declined to comment on the substance of our report due to the merger proceedings. Letters from FCC and Justice are included in appendixes IV and V, respectively.

Background

According to FCC, as of June 2001, just over 86 percent of television households purchased a subscription television service, as opposed to relying solely on free, over-the-air broadcast television. Of these subscription households, 78 percent received their service from a franchised cable operator while 18 percent received their service from a DBS company.[3] DBS historically has been popular in rural areas where cable service is unavailable to many households. Until a few years ago, there was a significant difference between the programming packages of cable and DBS: cable systems could offer the local broadcast channels, while DBS companies generally could not because of technological limitations and legal constraints. In 1999, following advances in satellite technologies, Congress enacted the Satellite Home Viewer Improvement Act[4] to, among other things, allow DBS companies to offer local broadcast channels via satellite. Today, EchoStar and DirecTV, the two primary providers of DBS services, each offer local broadcast channels to their subscribers in about 45 of the 210 television markets in the United States.[5]

DBS and cable also compete for subscribers to their broadband Internet access services.[6] Many cable companies have recently upgraded their cable systems and now offer a selection of digital services, including cable modem Internet access. Cable modem service is generally considered one of the fastest methods for home Internet access and is currently the most popular broadband service. DirecTV offers a two-way satellite Internet access service called DirecWay.[7] Few consumers subscribe to the current satellite Internet service, although future satellite Internet access

[3]The remaining 4 percent of subscription television households obtained service through other means, such as terrestrial wireless systems, satellite master antenna television systems (usually used in apartment buildings or other multiple-dwelling units), open video systems, and large "C-band" home satellite dishes

[4]P.L. 106-113, 113 Stat. 1501, 1501A-526 to 1501A-545 (Nov. 29, 1999)

[5]The market for a broadcast station is known as its designated market area (DMA). According to Nielsen Media Research, DMAs are used to identify television stations whose broadcast signals reach a specific area and attract the most viewers. Nonoverlapping DMAs cover the entire contiguous United States, Hawaii, and parts of Alaska.

[6]Digital subscriber line, or DSL, broadband Internet access and terrestrial wireless Internet access are also available in some areas.

[7]EchoStar previously offered an Internet access service called StarBand.

technologies are expected to be faster and more competitive with cable modems.[8]

Each DBS company is inherently limited in the number of programming channels and other services it can provide by the technical capacity constraints of its satellite fleet. Each satellite contains a certain number of transponders, or relay equipment, and each transponder can transmit a limited amount of information (i.e., video, audio, and data).[9] DBS companies have increased the capacity of their satellites through various technologies, such as digital compression and frequency reuse. Compression technologies conserve capacity by reducing the number of bits required to send digital information. For example, when transmitting video programming, compression eliminates the transmission of identical bits from frame to frame. Frequency reuse allows different programming to be transmitted over the same frequencies in different geographic areas. This is accomplished through the use of "spot beam" satellites that, rather than transmitting a signal nationwide, transmit to specific cities or other smaller geographic regions. As long as spot beams using the same frequency are at least a certain distance apart, interference among signals is avoided. Both digital compression and frequency reuse technologies have steadily improved since the launch of DBS in 1994 Satellite companies are also constrained by the number of orbital slots available for DBS services. Currently, DirecTV and EchoStar have the rights to all of the allocated frequencies at the three full-CONUS (i.e., the satellite footprint covers the entire contiguous United States) DBS orbital slots.

In October 2001, the two DBS companies signed an agreement wherein EchoStar would merge with DirecTV. One of the main arguments the companies put forth in support of the merger is that it would enable them to offer local broadcast channels to subscribers in all 210 television markets, something the companies say they cannot do independently. The companies have stated that their main competitor is cable—not each other—and that the ability to carry all local broadcast channels will make DBS a stronger competitor to cable systems. Opponents of the merger have stated that the companies could individually offer many more, if not all, local broadcast channels if they chose to do so and that the merger would

[8]Several companies are currently planning to introduce Ka-band satellite systems for broadband Internet access services for use by both consumers and businesses

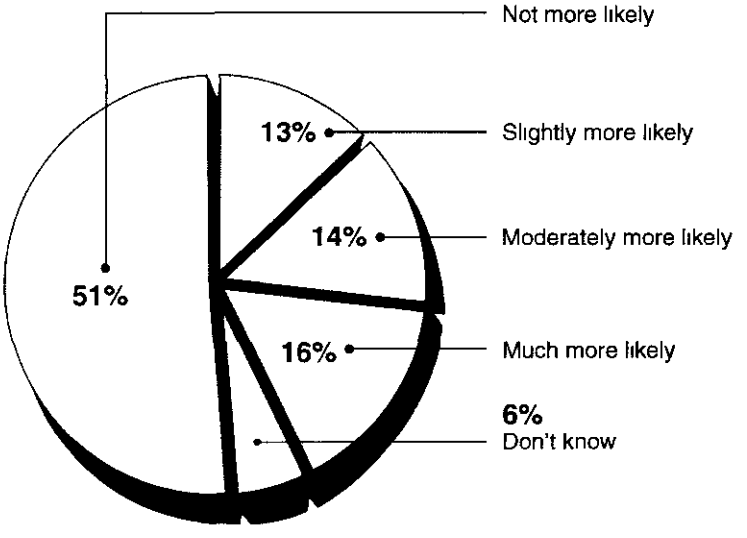
[9]A transponder will receive a signal, amplify it, change its frequency, and send it back to earth Individual DBS transponders typically have a bandwidth capacity of 24 MHz.

create a monopoly in DBS service provision, which is of particular concern to rural consumers who do not have access to a cable system. The proposed merger is under review by Justice FCC recently announced that it had declined to approve the proposed merger, although DirectTV and EchoStar have 30 days to file an amended application and to file a petition to delay the hearing. Congress has held several hearings on the matter.

For the Majority of Consumers, Internet Access Technologies Do Not Appear to Play a Major Role in Their Consideration of Video Service Providers

In our random telephone survey of consumers, we asked all of our survey respondents if, when thinking about purchasing television programming, the availability of cable modem Internet service would make them more likely to choose cable video service over satellite video service (see fig. 1). Fifty-one percent of those responding said "not more likely" while 16 percent said "much more likely." We also asked all of our survey respondents (excluding those few with satellite Internet access) if they had considered purchasing Internet service through a satellite provider; 88 percent said they had not.

Figure 1: Extent to Which Respondents Said That Cable Modem Internet Access Would Make Them More Likely to Choose Cable Service over Satellite Service



Source GAO consumer survey (May – June, 2002)

As shown in figure 1, almost one-third of respondents said that the availability of cable modem service was "moderately more likely" or "much more likely" to make them choose cable over satellite service. We also found the following:

- Respondents with higher household incomes were more likely to say that the availability of cable modem Internet access would influence their decision to buy cable video service.

- Respondents who were younger (from 18 to 34 years old) were more likely than older respondents to say that the availability of cable modem Internet access would influence their decision to buy cable video service.

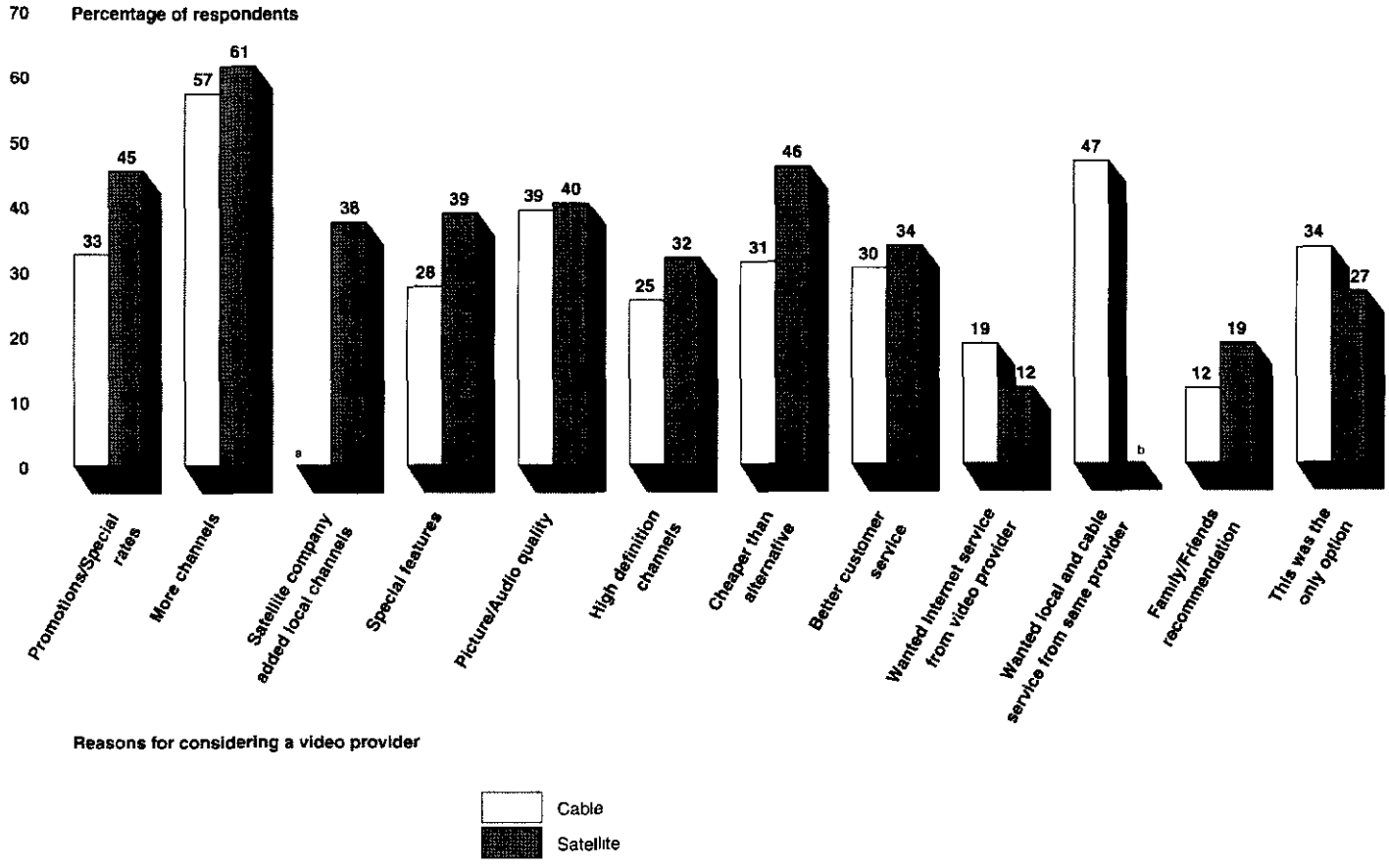
In addition to asking all respondents about the impact of Internet access on their video service decisions, we asked respondents who had begun purchasing or considered purchasing either cable or DBS service within the past 2 years to rate various reasons why they considered or purchased these services (see fig. 2).[10] Of those who began purchasing or considered purchasing cable, 61 percent said the availability of cable modem service was "not a reason" in their consideration or purchase of cable video programming services, although approximately one-fifth said cable modem service was a "major reason" for considering cable. The responses from those who had begun purchasing or considered purchasing DBS within the past 2 years were similar: 64 percent said satellite Internet access service was not a reason for consideration of DBS video services while 12 percent said it was a major reason

Other factors appeared to be important in consumers' consideration of video providers. Fifty-seven percent of cable respondents and 61 percent of DBS respondents said that a major reason for selecting or considering a video services provider was because they wanted more channels than they were receiving. Those who recently selected or considered cable also rated highly the ability to get local broadcast channels from the cable company and a better signal quality. Those who recently selected or considered DBS often reported that they considered satellite service because they believed

[10]Respondents were asked to rate a series of possible reasons as either a "major reason," a "minor reason," or "not a reason" in why they considered or selected either a cable or DBS provider See appendix II for the detailed questions and responses.

DBS was cheaper than cable and because DBS offered special rates or promotions.

Figure 2: Reported "Major Reasons" for Selecting or Considering Cable or DBS Video Services



[a]"Addition of local channels" was not asked of respondents who had selected or considered cable in the last 2 years

[b]"Wanted local and cable from the same provider" was not asked of respondents who had selected or considered DBS in the last 2 years

Source GAO consumer survey (May – June, 2002)

DBS Provision of Local Broadcast Channels Associated with Higher DBS Penetration Rates, but Not with Lower Cable Prices

According to our econometric model, the provision of local broadcast channels by DBS companies is associated with significantly higher DBS penetration rates. Specifically, our model results indicate that in cable franchise areas where consumers can receive local channels from both DBS providers, the DBS penetration rate is approximately 32 percent higher than in areas where consumers cannot receive local channels via satellite. Thus, in areas where the DBS companies offer local channels, it appears that DBS is more effectively able to compete for subscribers.

In addition to using an econometric model to study the competitive impact of DBS provision of local channels, we also examined the growth in the number of DBS subscribers between 1998 and 2001. This analysis was based on the percentage change in the number of DBS subscribers in almost all zip codes throughout the country. We found that in areas where both DBS companies introduced local broadcast channels, DBS subscribership grew by approximately 210 percent over this time period, while in areas where local channels were not available, it grew by 174 percent in the same time frame.

Our model results do not indicate that the provision of local broadcast channels by DBS companies is associated with lower cable prices.[11] In contrast, the presence of a second cable franchise (known as an overbuilder) does appear to constrain cable prices. In franchise areas with a second cable provider, cable prices are approximately 17 percent lower than in comparable areas without a second cable provider.[12]

[11]In some areas, cable companies have begun offering promotions to entice current DBS subscribers to switch to cable. For example, DBS subscribers in one area who turn in their satellite equipment to the cable company receive free cable installation and an approximately $25 per month reduction in their cable price for 1 year. Although these promotions can be thought of as a form of price discounting by cable operators, we do not know the extent to which such programs were in place during the time of our study.

[12]This was a larger effect than that found by FCC in its 2002 *Report on Cable Industry Prices* (FCC 02-107). Using an econometric model, FCC found that cable prices were about 7 percent lower in franchise areas when there was an overbuilder. One possible explanation for the difference in results is that we conducted further analysis of the competitive status of franchises that were reported by FCC to have an overbuilder. We found several instances where overbuilding may not have existed although FCC reported the presence of an overbuilder, and we found a few cases where overbuilders appeared to exist although FCC had not reported them. We adjusted our measurement of overbuilder status accordingly.

Finally, we found that the provision of local broadcast channels by DBS companies is associated with nonprice competition. In areas where both DBS companies provide local channels, our model results indicate that cable companies offer subscribers approximately 6 percent more channels. This result indicates that cable companies are responding to DBS provision of local channels by improving their quality, as reflected by the greater number of channels. In our July 2000 report, we also found that cable companies responded to DBS competition by increasing the number of channels.

Technical Considerations and Business Decisions Can Influence DBS Companies' Expansion of Local Broadcast Services

In 1999, the Satellite Home Viewer Improvement Act provided DBS companies with the legal right to provide local broadcast station programming.[13] To date, DirecTV and EchoStar have each introduced local broadcast service in about 45 markets, although DirecTV plans to offer local channels in about 70 markets and EchoStar plans to offer local channels in about 50 markets. However, providing local channels uses a satellite's transmission capacity—a limited resource on each satellite. Thus, there is an important trade-off that DBS companies face in deciding how many markets to target for local service. As DBS companies roll out local channels in more markets, satellite capacity that could otherwise have been used to provide services to all subscribers (such as national cable networks or interactive services) would be used to offer local channels to select groups of subscribers.

The two DBS companies have stated that one of the reasons they want to merge is to engender economies in the provision of local broadcast channels. In particular, the companies have stated that if they merge, they will, as a combined entity, have sufficient capacity to provide local broadcast programming in all 210 television markets and add new services, while continuing to provide their current number of cable programming

[13]DBS companies have a requirement somewhat analogous to cable's must-carry requirement. The Satellite Home Viewer Improvement Act allows DBS companies to provide local broadcast signals but requires in most circumstances that if they do so, they must provide subscribers with all of the local broadcast signals in that market, including stations affiliated with smaller networks and independent and public stations.

channels.[14] Several opponents of the merger contend that each of the DBS companies on its own has sufficient capacity to expand the provision of local broadcast channels into even more, if not all, television markets.

Key assumptions about the technical capabilities of the DBS companies' satellite fleets varied among those with whom we spoke. Opponents of the merger made assumptions about key technical factors—such as frequency reuse capability and advances in digital compression technologies—that were optimistic. The DBS companies held more conservative views about the technical capabilities of their fleets today and considered some possible enhancements to be based on technologies that are not currently available to them nor proven in terms of quality. We found that some of the assumptions of the merger opponents focused on potential capabilities that could not be readily incorporated into satellites already deployed and that would involve substantial replacement of consumers' DBS equipment.[15]

Our examination of various documents related to the two DBS companies' satellite capacity indicates that—given current technologies and deployed assets—neither company would individually be able to offer all of the local broadcast channels in all 210 television markets while simultaneously maintaining a competitive national subscription television service. Were either company to offer local channels in all 210 markets today, it would have to use much more of its current capacity for local channels, thus reducing its ability to offer the large numbers of national cable networks, pay-per-view channels, and other services that each company currently provides.[16] This would compromise the competitiveness of a DBS company with cable.

In the long term, however, with the launch of additional satellites and the deployment of or transition to new technologies, both DBS companies could choose to provide local channels in more television markets than they currently plan to serve. Of course, these decisions would involve

[14]Currently, the two DBS providers offer much of the same programming, such as the same national cable networks (e g., CNN and MTV), and offer local broadcast channels in most of the same markets A merger would allow the new company to increase its current capacity by ending this duplication of services

[15]EchoStar and DirecTV acknowledge that a proportion of DBS subscribers will also need to replace their equipment if they merge

[16]Additionally, DBS companies have contracts with national cable networks. Dropping these networks to expand local channels could prompt legal challenges by the cable networks

weighing the cost of such satellites or new technologies against the number of projected additional subscribers and other benefits that increased local broadcast offerings would bring to DBS.[17] That is, the decision of whether to introduce more local channels is essentially a business decision. Whether the benefits would outweigh the costs for the individual companies to roll out local channels in all 210 television markets is not clear.

Finally, it is also not clear how the transition of all local broadcast stations from analog to digital television (DTV) technologies will affect the offering of local broadcast channels by DBS companies.[18] The broadcast DTV transition is under way and will eventually culminate in the discontinuation of all analog broadcast signals. The DTV transition allows broadcast stations to provide high definition (HD) television signals—that is, a sharper television picture with roughly twice the lines of resolution of traditional analog pictures. However, even with digital compression technologies, the transmission of HD signals takes up far more satellite capacity than the transmission of traditional analog signals. If many of the roughly 1,600 broadcast stations across the country provide HD signals at the end of the digital transition (when the analog signals have been discontinued), it will take considerably more satellite capacity to provide the signals of the digital stations than it currently takes to provide the signals of the analog stations. However, the DTV transition may take several years, during which time advances in satellite technologies might mitigate this need for increased capacity. Nonetheless, at this time, the DBS companies' business decisions about local digital broadcast carriage at the completion of the DTV transition is unclear.

Agency Comments

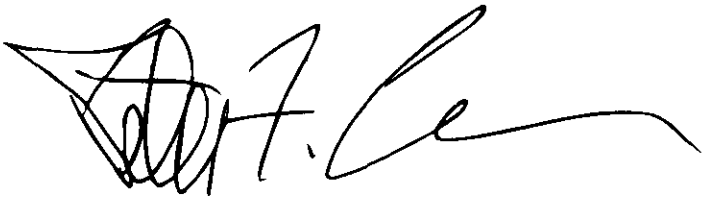
We provided a draft of this report to FCC and Justice for their review and comment. FCC staff provided minor technical comments that were incorporated as appropriate. Both FCC and Justice declined to comment

[17]Our model results indicate that there are benefits such as increased penetration rates in areas where local channels are offered EchoStar and DirecTV have noted other reasons that the companies desire to serve all 210 markets, such as the ability to market their service—including local channels—nationally.

[18]For more information on the DTV transition, see U S General Accounting Office, *Telecommunications Many Broadcasters Will Not Meet May 2002 Digital Television Deadline*, GAO-02-466 (Washington, D C Apr 23, 2002) We expect to release a second report on the DTV transition in November 2002

on the substance of our report due to the merger proceedings. Letters from FCC and Justice are included in appendixes IV and V, respectively.

As agreed with your offices, unless you publicly release its contents earlier, we plan no further distribution of this report until 30 days after the date of this letter. At that time, we will provide copies to interested congressional committees; the Assistant Attorney General, Antitrust Division, Department of Justice; the Chairman, FCC; and other interested parties. We will also make copies available to others upon request. In addition, this report will be available at no charge on the GAO Web site at http://www.gao.gov. If you have any questions about this report, please contact me at (202) 512-2834 or guerrerop@gao.gov. Key contacts and major contributors to this report are listed in appendix VI.



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